# A Mission-Centric View of the Firm: Lessons from Social Entrepreneurship

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## ABSTRACT

Social Entrepreneurship causes increasing debate in the literature and represents a growing enigma for theories of the firm. Beyond the divergences in its definitions, we show that its mission to create "social value" is an identifiable common feature that cannot be satisfactorily described within the main existing theories.

Indeed, social entrepreneurship is, by definition, inconsistent with the shareholder primacy advocating for the too narrow only objective of shareholder profit maximization. But it departs also from stakeholder views that focus on the survival of the firm by aligning its interests with discrepant and "overbroad" crucial stakeholders. Outwardly oriented missions in fact necessitate forgetting the dominant "principal-agent"-like settings, even if principals might be carefully and rightfully chosen.

We support our arguments with the study of two empirical cases that are successful long-lasting businesses related to social entrepreneurship: John Lewis Partnership and Equal Exchange. These companies have built pioneering custom-made governance systems – ensuring both performance and social fairness – that dispense with standard implicit hypotheses: their clearly explicit mission identifies "beneficiaries" that are distinct from crucial stakeholders, financial contributors, and principals. Instead, the mission becomes a pivotal attribute to explain and design these organisations' structure and mechanisms.

Consequently, we delineate three main theoretical and managerial implications of revealing this mission: it lends a strong legitimacy to the directors and officers by clearly defining the boundaries of their discretion, it specifies and justifies the participants' engagement in the management authority, and it calls for new control mechanisms that are fundamentally different from the monitoring systems of principal-agent relationships. Thus our model clarifies the firms' boundaries and escapes the traditional stakeholders' conflicts of interest.

We postulate that this model opens an interesting field for future research, both on social and conventional entrepreneurship, and may entail a deep change in managerial and governance techniques that may have reached a dead-end in the recent economic crisis.

Keywords: Social Entrepreneurship, Social purpose, Corporate Governance, Management Discretion

## Introduction

*« There is [...] much for conventional, institutional, and cultural entrepreneurship researchers to learn from the social entrepreneurship context. » (Dacin et al. 2010)*

Dacin, Dacin & Matear have argued that Social Entrepreneurship does not require a new specific theory to be fully described (P. A. Dacin et al. 2010). According to them, it is a “context in which established entrepreneurs operate” and existing theories apply, although with some differences that may be of interest for researchers in “conventional” fields.

On the contrary, we contend that the main existing theories cannot satisfactorily account for social entrepreneurship, which succeeds in escaping the usual theoretical dilemma between too narrow and “overbroad” conceptions of directors duties towards specific or underspecified groups of stakeholders. We postulate that the dominant “principal-agent”-like settings that are supported by the literature must be relinquished to describe the social enterprises’ organizations. Thus, our paper investigates two contrasted empirical cases related to the social entrepreneurship field to identify the most convincing explanatory factor of these peculiar organization structures.

By reframing a long and still hot debate, Dacin et al. highlight the lack of a convergent definition of what is “social entrepreneurship”. Indeed, numerous different concepts may define a social enterprise depending on who is their creator (Plerhoples 2012). It may describe business that address directly social needs through their products, “blended enterprises” (Reiser 2010) that make considered choices between profit and social good to sustain “double” or “triple bottom line”, or business that seek to simultaneously promote the two through a “blended-value” (Emerson 2003).

Yet, beyond these different definitions, Dacin et al. note that *“the notion of providing social value or some derivative of social value appears to be a common theme across the majority of social entrepreneurship definitions”* (P. A. Dacin et al. 2010). This common theme may be qualified as the “mission” or the “purpose” of the enterprise.

Should this purpose be comprehensive (i.e. addressing all possible “social benefit” criteria from the environment to the society, including governance choices and internal stakeholders)(Munch 2012; Reiser 2011) or specific to a peculiar cause (Plerhoples 2012), it appears to be a specific characteristic for each social enterprise that must be designed and operational.

In this paper, our purpose is to challenge the conventional framework by assessing the explanatory and designing power of this mission. We contend that Social Enterprises exhibit a pivotal attribute that is overlooked by the existing theories but should be integrated in a meaningful theory of the firm. In turn, we intend to show that it enables reconsidering the traditional roles of corporate governance, legitimating a broader and “mission-controlled” discretion for management, redefining the participants’ engagement and building a collective by creating solidarity rules. Finally, we suggest that this attribute may also be of great theoretical interest in conventional fields and that further research may be needed to reassess the purpose of the firm.

## 1. Can we really account for Social Entrepreneurship within the existing theories?

### *1.1 Social Entrepreneurship defies the shareholder primacy*

Since the seminal paper by Jensen & Meckling (1976), agency theory is the dominant frame to analyse the firm in the literature (Dalton et al. 2007). Using the mathematical description of the “principal-agent problem”, the agency theory advocates for mechanisms that control the discretion of the management to avoid opportunistic behaviour that may divert resources and reduce the performance of the firm. Shareholders being depicted as taking the most risks among the participants in the firm because of their position of “residual claimants”, they would then be the most legitimate to control the managers to ensure the efficiency of their decisions.

As Donaldson has recently demonstrated (Donaldson 2012), this analysis prepares the ground for an implicitly normative argument about what should be the purpose of the firm. From ensuring the “performance” of the firm, the “shareholder primacy norm” shifts to a novel objective: the shareholder profit maximisation (Lazonick & O’Sullivan 2000).

Extensive criticism of this exclusive shareholder value as the “corporate objective function” (Jensen 2001) has been written, notably to contradict Friedman’s thesis that this objective is the only social responsibility of the corporation (Friedman 1970).

Throughout the different definitions of Social Entrepreneurship (Plerhoples 2012; P. A. Dacin et al. 2010; Katz & Page 2010; Mendell 2010), we can highlight two fundamental common features. First, the social enterprise must provide social value as a necessary purpose of either its actions or its products. Second, this social value, whether taking precedent on, competing with or going together with profit, is not “profit” itself and must be explicitly distinguished from profit.

On the opposite, the agency theory associated with shareholder primacy recommends that no other goal than shareholder profit maximization be considered, what makes it inappropriate by definition to qualify social entrepreneurship. It suggests that the purpose of the whole corporation (and specifically of its managers) emerges from the specific state (residual claimancy) of a single class of its participants, determined by the specificity of their contribution. This creates obviously no consensus among even the narrowest pool of actors involved in the firm’s activity, since the shareholders themselves have competing interests

(Hoskisson et al. 2002; Carney et al. 2011). In fact, it automatically precludes all other participants than shareholders (including managers) to have a say in their enterprise's ultimate purpose.

Social enterprises give good examples to argue that not all firms have the same mission, and that it is a deliberate and collective choice to make that will constrain the firm's strategy. The agency theory implicitly makes one believe that shareholder profit maximisation is the only objective to be conceivable for both legitimacy and efficiency. Numerous papers since Blair & Stout (1999) have shown that the "residual claimancy" argument is fallacious (e.g. Lan & Heracleous 2010; Asher et al. 2005), and that a broader set of relevant "stakeholders" shall be considered, not to say take an active part, in the definition of this purpose, either on legitimacy or efficiency grounds (see infra §1.2).

Finally, the agency theory, by directly equating this purpose to the shareholders interests, advocates for a direct control of the managers by the shareholders in person (as principals), thus creating a short-circuit between the corporation and the shareholders (Blair & Stout 1999). This contributes to hide the normative shift leading to designate the shareholders as the legitimate ultimate beneficiaries of the whole firm. Social Entrepreneurship, on the contrary, needs to separate the firm's interest from the interests of its shareholders, as social value must *a minima* be provided to a greater circle than the one of the financial investors. In turn, the "shareholder primacy" version of agency theory is too narrow to account for social entrepreneurship because it reduces the purpose of the firm to the single financial interest of one restrictive group of principals.

### *1.2 Social Entrepreneurship escapes from the pitfall of "aggregate welfare"*

The stakeholder view has been popularized by Freeman (1984) as an alternate conception of the firm. Its core proposal is to consider a broader set of participants in the firm for each management decision, what should *a priori* provide a better frame to account for the Social Enterprise's bet to provide social value beyond the frontiers of the corporation.

Yet, the first formulation by Freeman of the purpose to include external stakeholders in the scope of the strategic management of the firm was to prevent any internal or external action to be harmful to the firm, having considered a "turbulent environment". In this way, Freeman acknowledges the organization's objective as being its own *survival* (R. E. Freeman & McVea 2001).

From this strategic point of view it becomes of the utmost importance to identify what are the different stakeholders so that managers be able to anticipate and "balance" their interests.

Varied definitions have thus been taken to contain what should be the relevant stakeholders for the firm. Donaldson & Preston (1995) identify several competing definitions: "those groups without whose support the organization would cease to exist" according to the SRI (quoted p.72), "anything influencing or influenced by" the firm in Freeman's view (quoted p.86), "people who have a stake in the business" for Kotter & Heskett (quoted p.71). But according to the authors, "stakeholders are identified by *their* interests in the corporation, whether the corporation has any corresponding functional interest in *them*" (emphasis in original). Further work has since contributed to arrive at the better delimitation of the stakeholders according to the firm's context and governance (Mitchell et al. 1997; Fassin 2009; Carney et al. 2011; Post et al. 2002).

Assuming the suitable definition of stakeholders to be accepted, "the very purpose of the firm is […] to serve as a vehicle for coordinating interests" (T. Donaldson & Preston 1995). Indeed, it is a permanent feature of the stakeholder view (confirmed by Post et al. 2002) that the main objective of managers is to "balance" the interests of all the identified participants: "stakeholder management is a never-ending task of balancing and integrating multiple relationships and multiple objectives" (R. E. Freeman & McVea 2001).

This entails that the very mission of the firm is entirely defined by the list of "salient" stakeholders that have their own competing objectives. And the salience of these stakeholders depends on their own attributes rather than on the firm's own strategy (Mitchell et al. 1997) and is differently defined depending on the different authors. Consequently, critics have pointed out that this list is at best "vague" and idiosyncratic (Orts & Strudler 2010). Moreover, these *de facto* stakeholders may form an overly broad area of concern for the firm thus leading to an intractable "aggregate welfare" obligation, namely to carefully weight the interests of a potentially endless list of people that might be "influenced" by the firm.

From the Social Entrepreneurship viewpoint, we add that it makes of the identification of a coherent social purpose an impossible task. Orts & Strudler remark that none of the papers on stakeholder view would argue that stakeholders' interests could always be made to align, hence the commitment to a never-ending "balancing without objectives". In fact, it should be noted that every stakeholder model that has been drawn since Freeman (R. E. Freeman 1984; R. Freeman et al. 2007; Post et al. 2002; Fassin 2009) represents the firm as a black box and assume its pre-existence to identify the stakeholders. This precludes the theory of identifying any means to determine an appropriate purpose of the firm beyond those of each stakeholder involved. Therefore, in such a system managers would "have no way to make *principled* or *purposeful* decisions" (Jensen 2001, emphasis added).

Building on these arguments, the *collective design* of a social purpose that would be different from those of all the stakeholders involved is forcefully ruled out. The “Extended Enterprise” model (Post et al. 2002) incidentally makes it clear that core stakeholders are those from the “resource base”, thus ruling out the possibility to run the firm primarily towards an external purpose. Furthermore, managing a social enterprise that may clearly favour one group of stakeholders over the others should prove intractable if all stakeholders are given an equal right of bargaining (Donaldson & Preston 1995 quoting Evan & Freeman). If the legitimate and operational aspects of the stakeholder view are questionable for the “conventional” firm, and have indeed be extensively questioned (e.g. Jensen 2001; Orts & Strudler 2010; Carney et al. 2011; Reynolds et al. 2006), we contend that they also do not satisfactorily apply to the Social Enterprise.

### *1.3 Social Entrepreneurship challenges the legitimacy of internal stakeholders' control*

Research has been successful in developing formal theories that may support the stakeholder view (Grandori 2005), such as the Team Production Theory (Blair & Stout 1999) or a revisited form of the Property Rights Theory (Asher et al. 2005). Heracleous & Lan (2012), building on the landmark paper of Margaret Blair and Lynn Stout, insist on the broad discretion that is granted to the directors by corporate law that generally presupposes their competence to run the business. As “Mediating Hierarchs” mandated by the corporation, they would not be agents of a particular group of stakeholders but of the corporation itself. However, in accordance with the stakeholder view, they admit that ensuring the long-lasting firm-specific investment of the crucial stakeholders impose a “prioritization” role for managers that would prevent them to pursue a mission that does not distributes equally satisficing returns (Lan & Heracleous 2010; Heracleous & Lan 2012). Although providing a mechanism that should at least prove “socially responsible” regarding internal stakeholders (notably employees), they provide instrumental and normative arguments (Donaldson & Preston 1995) that seem to impose a one best way, similarly to the agency theory, and to prevent from conceiving a social purpose diverging from the interests of the core stakeholders.

The Property Rights approach (Asher et al. 2005), bringing back the work by Hart, Grossman and Moore in the same way, provides new arguments to build a form of stakeholder-agency theory (Hill & Jones 1992) in which relevant stakeholders (identified by the incompletion of their contracts due to the specificity of their investment) would be the principals instead of the shareholders. Here the preceding arguments about the competing interests balancing objective and the direct control of managers in agency theory remain valid: though extending the circle of potential beneficiaries to other internal stakeholders, this conception cannot satisfactorily account for a social enterprise choosing an outwardly oriented mission.

In fact, although the general stakeholder view could be flawed by the "overbreadth" (Orts & Strudler 2010) of the discretion left to the managers in considering the varied potential stakeholders of the firm, formal "stakeholder theories" fail to account for social entrepreneurship because they reintroduce some forms of principal-agent relationships between "invested" stakeholders becoming rightful principals and directors that cannot design a purpose that is not aligned with these new principals' interests.

### *1.4 Theoretical outcomes*

At this stage, it appears that theoretical constructions of the firm assume an implicit mission that should be deduced from its context and is constrained by the necessary participants of the firm (either shareholder primacy or stakeholder balancing). Social entrepreneurs would then not have room of manoeuvre to invent and design a principled social mission to their enterprise, since privileging a particular (especially externally oriented) purpose over the crucial stakeholders should prove inefficient and jeopardize the firm's survival. Moreover, as directors are in turn always described as agents of some of these rightful stakeholders becoming new species of principals, they should be directly monitored by these people, what the "mission" is certainly not able to do by itself. Recent work does not reappraise this conclusion but find new arguments that may constrain or logically imply the definition of a firm's behaviour, which may be related to the personal values and ideologies of the managers (Adams et al. 2011), to the structure of authority due to the mode of governance of the firm (Carney et al. 2011), or to the influence of the institutional context that may redefine the "principal-agent" relations (Wiseman et al. 2012).

## 2. Research Questions & Methodology

Our research questions stem from this inadequacy of main theories to account for a peculiar attribute that is revealed by the Social Entrepreneurship literature: how to explain the specificity of social entrepreneurship *vis-à-vis* standard theories and is this "mission" a convincing factor? How does the mission help understand the specificities of the governance of the social enterprises? What could be its implications for both theory and practical management?

To support our research on these questions, we have chosen two contrasted empirical cases that are related to Social Entrepreneurship. Our methodology lies at the crossroads between i) the "pursuing failure" methodology (Gray & Cooper 2009) through the specific choice of counterexamples that cannot be theorized within existing theories, and ii) the case study research (Glaser & Strauss 1967; Yin 2009; Siggelkow 2007) and inductive theory building (Eisenhardt 1989) in that we use these cases to reveal some interesting attributes that may be of interest for new theoretical outcomes.

Accordingly to this literature, our counterexamples are contrasted and offer original forms for governance that supersede existing models, while being performing, long-lasting and viable firms with workable structures in the current legal framework (which incidentally appears to be rather plastic and permissive). We also use these cases to shed light on the shortcomings between competing theories, and to specify some boundaries to their legitimate domain.

As Siggelkow has argued, we are thus not looking for the representativeness of our cases but we believe that they are of strong inspirational power for a more general theory beyond their specificities. In this respect, we propose a "free-standing" model (Siggelkow 2007) drawn from our observations and advocate for further research to refine its potential descriptive and predictive power and its own legitimate domain.

Besides, as we are mainly using publicly available information and existing literature to ground our discussion, the new attributes we bring from these cases to base our proposal still need to see their potential confirmed and put to the test through more representative empirical cases, and the development of further research in this direction.

## 3. Empirical Data

We rely on two empirical cases that may be related to the social entrepreneurship sector: John Lewis Partnership, a UK actor of the retail sector, and Equal Exchange, a US-based cooperative acting in Fair Trade.

### *3.1 John Lewis Partnership*

John Lewis Partnership (JLP) is a private group operating John Lewis department stores and Waitrose supermarkets in Great Britain. The first store being founded by John Lewis in 1864, it is one of the oldest enterprises to operate in the retail sector in the UK. By the year 2012, the group had a revenue of £8.7 billion, and more than 80,000 employees. Its sales' growth and operating profit margin are comparable to those of its competitors on the UK market (Tesco, Asda, Sainbury's, Morrissons), a few of them having additional international branches with different performance. However, John Lewis Partnership has no external shareholders, and redistributes its profit to the employees, in the form of an annual bonus amounting to 10 to 20% of the annual pay.

It is worth noting that John Lewis Partnership is not a partnership in the legal sense. It is composed of mainly 4 companies, John Lewis Partnership PLC, John Lewis PLC, Waitrose ltd. and John Lewis Partnership Trust ltd. The firm is called "partnership" following its founder's wish.

The partnership's shares are entirely owned by the Trust, for the benefit of the partnership's "past, current and prospective employees" (Bradley et al. 1990), who are to be called "partners", following the trust settlement of 1950 (Lewis 1954). Although this is a common feature of what is called "employee-owned" firms, notably in the US with Employee Stock Ownership Plans (ESOPs), it remains fundamental to observe that partners (employees) do not own shares (the Trust is the sole shareholder), and that this Trust was, as a legal person, designed in the first place.

Namely, it is the partnership founder, John Spedan Lewis, who designed it in 1950. Five persons are directors of the Trust, among who three are elected partners, and the Deputy Chairman of JLP. The Trust is designed so that its Chairman and last director be John Lewis Partnership's Chairman itself, thus preventing the Trust as a shareholder to go against the Partnership's board decision.

Second notable feature, the firm's objectives and principles are "enshrined in a constitution", which dictates the governance structure of the firm (power, income and knowledge sharing). According to the constitution, although being legally the only shareholder, the Trust has no management power beyond i) the role of watching to the "constitutionality" of management decisions, ii) the definition of constituencies for partners to vote, and iii) the power to accede to the partners wish to remove the Chairman in extreme situations.

So far, this shareholder of a unique kind has thus no voting right, and does not earn dividends, which are yielded to the partners in the form of the annual bonus.

It would seem obvious at that point that the voting rights are also yielded to the partners to balance the abnormal discretion latitude of the chairman. Yet, in opposition to conventional employee-owned firms or co-operatives, partners are not entitled to elect the partnership's board, nor their Chairman. The Chairman designates its own successor, and half of the board of the John Lewis Partnership PLC. It is really the true locus of the management, combining the roles of CEO and Chairman (Bradley et al. 1990). The management has very large room of manoeuvre in both accomplishing day-to-day actions and determining long-term strategies.

Instead, the partners vote for a "Partnership Council" which is of course not a legal attribute of the PLC. The council is responsible for representing the partners' interests (taken as a community, instead of individual interests). In general meetings, it elects, in turn, the other half of the PLC board, as well as the three trustees. This council, acting close to a legislature to the executive (Bradley et al. 1990) has constitutionally the power to ask the Chairman to account for its decisions and to "make recommendations" regarding its strategy.

Finally, the partnership council is able to ask the trustees to remove the Chairman if the latter fails to justify the constitutionality of its decisions. Although this removal power justifies, in the view of Bradley et al., the fact that employees ultimately control the partnership, we can observe that this removal strongly depends on the criteria that make a management decision "constitutional". The main criteria to assess the constitutionality of a decision are enclosed in the "principles" section of the constitution, the first and main article of it being: "The Partnership's ultimate purpose is the *happiness of all its members*, through their worthwhile and satisfying employment in a successful business"[1] (emphasis added).

Consequently, it is through its legal obligation to hold the shares for the benefit of the partners that the three elected trustees may use their director power to remove the chairman of the Trust ltd, thus removing the chairman of the Partnership (same person). This, in turn, appears to be the only possible way to effectively control the executive.

### *3.2 Equal Exchange*

Equal Exchange was founded in 1986, in the context of a political crisis leading to an embargo on the import of coffee from Nicaragua. From the very beginning, the founders chose to design their firm according to their own moral and political principles. On the one hand, they built their enterprise to fight against the inequalities in the global system of coffee trade (and food trade in general) – which often leads to prices much too low for acceptable working and living conditions of the farmers (producers) – and, in their own terms[2], to offer fairness and empowerment to farmers and consumers. They were among the first American firms to adopt the Fair Trade chart that has initially been written in Europe.

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[1] John Lewis Partnership Constitution as of December 2011, at http://www.johnlewispartnership.co.uk/about/our-constitution.html

[2] See Equal Exchange's website on http://www.equalexchange.coop (last accessed March 2012)

On the other hand they chose the co-operative form based on the two principles that frame the co-op status: workers shall hold the majority of the voting rights, and these rights shall be distributed so that each person gets one vote.

Equal Exchange today employ more than 100 people, and had over $35 million sales in 2011. Their primary activity is coffee roasting although they have diversified in other Fair Trade activities, such as sugar or fruit.

Its governance structure is typical of a co-operative. Every worker is required to buy exactly one share (around $2,500 thanks to a 4-year no-interest loan offered by the firm) that gives a voting right. “Worker-owners” elect the 9 members of the Board of Directors, three of them are “outside members” (i.e. not workers). The directors then hire two workers to be Executive Directors, who are in charge of the management and the recruitment of other workers. When workers decide to leave the co-op, or are dismissed, they must sell back their share to the firm and are refunded at the purchase price. Equal Exchange’s articles of incorporation also require that the ratio between the higher and lower pay (per hour) must not exceed 4 to 1.

Equal Exchange is an interesting case because of its financing structure. Indeed, its activities and social choices require high working capital, for example because they want to grant the poorest farmers the possibility to invest in their means of production before having the coffee to deliver. This means investing substantially in a risky cultivation, months before getting the raw material that base their roasting activity. Equal Exchange thus provides practical innovations to solve a common hurdle met by the co-operatives: attracting external investors.

Its capital is divided in two types of stock, “class A common shares” that are voting shares exclusively held by the workers, and “class B preferred stock”, which are sold to external investors. Class A shares give right to “patronage rebates” that are not correlated to their nominal or present value, but to the profit of each year. The by-laws require that the rebate should amount to 40% of the net profit or loss, after state income taxes and preferred stock dividend payments, but before charitable donations and federal income taxes. At least 20% of the rebates shall be paid in cash to the workers, the rest being added to individual accounts that increase the (variable) capital of Equal Exchange and may be used to cover losses in case of a negative result.

As noted, Class B stock give only right to dividends. They are “targeted” at 5% of their purchase price ($27,50 in 2011) but are not guaranteed. Indeed, the board has the discretion to set this rate every year, although it has for now always met the target. This preferred stock is not transferable and gives no voting right. It is redeemed by the co-operative *after 5 years* at the selling price, or at lower price after 3 or 4 years. However, these shares are "preferred", which means their dividends are paid before the patronage rebates and thus do not support the primary financial risk. Over the few past years, we observe that the amount paid in dividends for preferred stock is comparable to the total rebate paid to the workers, what gives this insurance a real interest.

This financing structure is deemed to be a success, as 96% of the capital is made up preferred non-voting stock, amounting to $9,1 million in 2011 against about $300,000 of class A shares. Yet, the workers own 100% of the voting rights. Investors, on the other hand, have benefited from a 5% rate over the fifteen past years, which is a much better result than that of an amount equally invested in the US S&P 500.

Practical innovations also include the first ever issued *firm-specific* Certificates of Deposit, according to Equal Exchange. Class B stock is granted to a small number of chosen external and mainly institutional investors, and extending the system to the general public without a specific market would be too costly. Equal Exchange thus entered into an agreement with a bank (Eastern Bank as of 2012) to create a certificate of deposit that is specific to the enterprise. Instead of standard interest-bearing time deposits that the bank may use for its own operations, which may maximize the return while spreading the risks, these firm-specific deposits make the money exclusively available to Equal Exchange through a low-cost line of credit. Customers that choose this type of deposit benefit from a guaranteed interest rate over the time before withdrawal, but may still be considered as "investors" since they bear the bankruptcy risk as a standard lender would. Indeed, while the bank is FDIC insured for its own potential insolvency, it has not to refund its customers if Equal Exchange cannot repay its debts. It is worth noting though that the firm must repay these deposits as standard debt before considering paying out dividends, even for preferred stock.

## 4. Discussion

### *4.1 Deconstructing the implicit hypotheses of the theories and revealing a new attribute*

*Business beneficiaries are not crucial stakeholders or contributors*

John Lewis partnership and Equal Exchange seem to fall within the teratology domain, when analysed from the conventional theories of the firm.

For example, following the stakeholder frame that we established earlier, the firm ultimate purpose should be its survival, which is utterly dependent on the balanced satisfaction of the competing interests of the relevant stakeholders. The first step to describe the firm's organization would then be to identify the list of relevant stakeholders (Post et al. 2002 p.23).

Ruling out shareholders, the "Resource Base" of JLP includes employees, lenders and customers (according to Post, Preston & Sachs). From the "Industry Structure", relationships to suppliers, and regulatory authorities can be identified; from the outer "Social Political Arena" mainly local communities, and recently the UK government, are linked. This shareholder view has an undeniable descriptive power, as JLP is recognised to lead particular politics towards each group of these stakeholders, which are identified in the constitution.

However, this constitution acknowledges that the "ultimate purpose" of the partnership is entirely directed towards employees, somewhat leading to consider all the other stakeholders as being minor, or "secondary" (Mitchell et al. 1997), including crucial ones such as customers, clients or suppliers. And yet, employees are not given the direct right to control the management decisions, but only to "make recommendations", which would seem to be a rather weak bargaining power to prevent managers from behaving opportunistically.

Furthermore, according to Post et al. the next step is to "specify the goals to be achieved in each stakeholder relationship", so that the firm may ensure its survival. To that end, traditional relationships with employees include efficiency and commitment, with customers, satisfaction and best value, with suppliers, loyalty and cooperation, with lenders, trust and responsibility, with regulatory authorities and government, compliance, and with local communities, fairness and assistance. Yet, JLP's constitution claims to primarily pursue the *happiness* of its employees, without any condition on their efficiency, and even subordinates the condition of the business success to that ultimate aim.

Equal Exchange's governance leads to a similar enigma: their acknowledged purpose is to help the farmers, who seem not to be given any bargaining right, but somehow justify to put the firm deliberately at risk and to ask its investors to engage their money for 5 years without even guaranteeing their return or giving them voting rights.

Thus, we observe that a new class of "stakeholders" is emerging that we may call "beneficiaries", who are directly concerned by the purpose of the firm and benefit from either its activities or its outcome. These cases show that beneficiaries are not to be confused with crucial or primary stakeholders, contrary to the claim of the stakeholder view, and with financial contributors, as would claim the shareholder primacy norm.

*Beneficiaries are not principals*

Theorization by Asher, Mahoney & Mahoney (2005), would have led to a more prescriptive governance system. The incomplete contracts theory in the case of the John Lewis Partnership presumably leads to only consider employees, assuming that lenders only commit in complete contracts (no specific investment necessary). Therefore the most foreseeable organisation form would be a co-operative organization in which employees are principals and managers are agents. Managers would then be directly constrained by employees to pursue their own benefit. The Team Production Theory would probably lead to the same results, considering that directors would owe fiduciary duties towards the corporation, which is almost exclusively made up of employees, and would then be mediating hierarchs between employees and… other employees.

These organization forms are traditionally bundled in the "employee-owned", "worker-owners" or "employee-shareholders" designations. Interestingly, this is a common short-circuit used to describe JLP. Yet, as we have seen, the reality of the relationships between directors, managers and employees is far more complex. In particular, quasi-autonomous management and the additional democratic representative system are not constitutive of the co-operative forms. Moreover, the prerogative, granted to the partners, to remove the chairman is entirely dependant on a failure to follow the partnership's constitution, and is quite different from the possibility usually granted to the shareholders to remove them without cause.

Likewise, Equal Exchange's cooperative form is predictable (although investors here are asked to strengthen their engagement through long-term and non-guaranteed results) but would be unable to explain its Fair Trade mission, i.e. why the beneficiaries of the firm's activities are not primarily the workers themselves.

*Revealing a pivotal attribute: the mission*

In fact, we demonstrate that all conventional governance theories equally presuppose that management decisions must be controlled by a specific group of stakeholders, either because of the risk of opportunistic behaviour, or to ensure better performance.

The Agency Theory with shareholder primacy norm merges the three roles of capital contributors or holders, revenue beneficiaries and voting rights holders. It suggests two types of reasons to make of these shareholders the legitimate principals to control the directors-agents: the instrumental argument that being residual claimants they are best placed to ensure the firm efficiency, and the normative argument that being "owners of the corporation" (in fact of its shares), they have the legitimacy to be the principals.

The stakeholder view urges managers to identify new types of contributors (e.g. through specific investment) that must become beneficiaries of the firm and in turn largely constrain the management discretion, either because of the instrumental argument that taking critical stakeholders into account will boost the firm's performance or the normative argument that people who have stakes in the enterprise must legitimately be considered.

Finally, these theories always consider different forms of contracts between some "principals" (shareholders, stakeholders or the corporation itself in the case of the Team Production Theory) that may impose their interests and directors that are mandated and must then be monitored. Therefore, they ensure that this "mandate" aligns the firm's purpose with the interests of the "principals", thus invariably focusing the debate on who should be the rightful "principals". Hence the numerous debates on ownership versus control, stakeholder salience, shareholder primacy and the "true" legal prescription. Interestingly, the Team Production theory insists on the broad discretion that is offered by law to the directors as agents of the corporation (relationship that is materialized through the fiduciary duties). However, ensuring the long-lasting engagement of participants that bring firm-specific investments still requires a "prioritization" between the different stakeholders and perhaps also the monopolizing of surplus by the shareholders, which remain the only participants to nominate the directors (Heracleous & Lan 2012 p.232).

These cases open a different path, by establishing a purpose to the firm that is not drawn from the list of the salient stakeholders and does not assume a pre-existing power structure. For example, John Lewis Partnership's constitution clearly enacts the partnership's mission: "the happiness of all its members, through their worthwhile and satisfying employment in a successful business".

*The mission is not a "principal"*

Bradley et al. have equated this mission to the maximisation of the present value of the Trust, therefore to the maximisation of JLP's profit (Bradley et al. 1990 p.389). By doing this, they make two implicit hypotheses: that the purpose of a firm is inevitably of financial nature, and that partners are implicit principals, who can impose their interests because of their alleged removal power. We argue that making this mission explicit has a much broader meaning.

On the one hand, the purpose as expressed in the constitution entails much more than the simple short or long-term profit. “Worthwhile and satisfying employment” easily call for numerous criteria: working conditions, wages pensions and other advantages, management attention, training and employability, career, health, diversity and attractiveness of jobs, working atmosphere, satisfying relationships to customers etc. These can of course be thought as relevant “performance” criteria, but also serve as guidelines for management in their diversification, growth, and employment strategies as well as for day-to-day actions in stores.

On the other hand, instead of trying to balance the interests of primary stakeholders in a fuzzy manner, the mission may directly be used to monitor the sharing of power, which is the role of the trustees that ensure fair elections, define constituencies and control the ‘constitutionality’ of decisions; but also the sharing of income, which is the ground for the annual bonus redistributed to every partner according to their pay and may amount to 20% of it; and the sharing of knowledge, principle that is at the origin of a wide network of representation through branch forums, registrars, counsellors and meetings, “backed by an extensive system of company journalism” (Bradley et al. 1990).

More precisely, we contend that designing an explicit mission has three major consequences on the management of the organisation: it lends a strong legitimacy to the directors and officers by clearly defining the boundaries of their discretion, it identifies the relevant stakeholders by defining their engagement, it calls for new control mechanisms that are fundamentally different from the monitoring systems of principal-agent relationships.

### *4.2 Theoretical and managerial implications of designing a mission*

#### *a) Strong legitimacy and clear demarcation of the management discretion*

By ensuring the constitutionality of management decisions, the existence of the purpose lends a strong legitimacy to the Chairman and its hierarchy structure. This, in turn, makes the case for a wider discretion for managers, and justifies their empowerment through their competences rather than through a stakeholders’ direct representative system, which has greater chance to bring conflicts. Their legitimacy is ensured i) by the ability handed over the partners to dismiss the Chairman if he/she is not able to demonstrate the positive impact of a decision on the happiness of the members (which is precisely the mission), ii) by the adjoining a democratic system of representation that does not directly constrain the managers but hold them to account, and iii) by the legal obligation of the Trust, single shareholder, to hold the shares for the *benefit of the partners*.

The use of a Trust is not very innovative in itself, since it is a common technique used to allow employees to "own" stock without changing the basic rules of the standard corporation. Theoretically speaking, however, it is an interesting way to differentiate the different "functions" of shares, as dividends ("revenue" function of stock) are handed over the employees while voting rights ("control" function of stock) are kept "safe" from them, thanks to the design of the Trust – legal person – itself, which may be controlled by the corporation. "Benefit" would here be taken as the mere financial outcome of stock, somewhat restraining the legal obligation to its simplest conception.

The montage for JLP goes one step further as the Trust gives in both functions, thus being a peculiar kind of shareholders that would be deprived of both dividends and voting rights. In fact, the technique ensures the pursuit of the partnership's purpose – the happiness of its members – by making of the legal obligation of the Trust – holding shares for the benefit of the partners – an effective way to hold the chairman accountable: as the single shareholder, the Trust has the legal power to remove the chairman if doing so would benefit to the partners.

Thus, shareholders, revenue beneficiaries, and voting rights holders may very well be three different groups of people. In addition, John Lewis Partnership's governance redefines what are the voting rights themselves: they are not a means to elect the corporation's board anymore, which previously designated its chairman and top executives, but a means to constitute a kind of legislative assembly (Bradley et al. 1990) that defines the frame within which the executives may act, and holds them accountable.

This structure departs clearly from the conventional theories and would be incomprehensible without exhibiting both the constitution and its mission. Indeed, we observe that there is no principal anymore, as voting rights have been redefined to shape the conditions within which directors and managers have their own legitimacy. Consequently, the mission becomes the only possible way to effectively control the executive through the ultimate sanction of dismissal, hence the existence of the Trust, a shareholder devoid of voting and surplus rights.

Therefore, the mission-centric management enables a decoupling between the different governance roles (capital contributor, principal, voter, revenue beneficiary, etc.), which can be recombined in the very interest of that mission without prejudging their legitimate distribution. We contend that the mission is then explicitly the only normative argument that must guide the design of the collective organization.

*b) Emergence of a theory of engagement and solidarity*

Thus, the design of a purpose reverses the management process as detailed by the stakeholder view. According to this view, which assumes the pre-existence of the firm, managers have to identify the list of salient stakeholders, and to deduce constraints in order to take their relationship into account, without determining any guiding objective. The design of purpose, on the contrary, is of corporate interest and must be decided to “define” the enterprise scope of action and underlying strategy.

This purpose naturally identifies the “salient” stakeholders thanks to a self-supporting principle: the mission gathers the people that accept to “work” for it, or at least to curb their own interests in its direction. This prerequisite mechanically entails the *collective* aspect of the design, and a new definition of stakeholders as being the people that a) are designated beneficiaries or necessary contributors to the mission, *and* b) accept to hand over the enterprise authority (namely its management structure) a part of their own action and decision power (Segrestin & Hatchuel 2011).

This has two fundamental consequences. First, it erases the impossibility to define a mission that is not directly aligned with the interests of all stakeholders by reversing the dependence link, what enables social entrepreneurs to promote an outwardly oriented social mission. Second, it gives a new definition of the stakeholders’ engagement, what clarifies the firm’s boundaries and enables targeted collective rules (such as solidarity rules).

Equal Exchange, for example, clearly exhibits an externally oriented mission: to offer fairness and empowerment to farmers and consumers. This mission, as for John Lewis Partnership, implies a large list of criteria that may go far beyond fair purchase money for farmers and selling price for consumers. We have already mentioned the early investment for the poorest farmers to develop their production capacities, what requires high working capital for Equal Exchange.

Consequently, we identify a few groups of stakeholders that match our new description: beneficiaries or necessary contributors that recognise the enterprise authority on part of their decisions. Workers who roast the coffee to produce saleable beverage ingredients; and investors that participate to Equal Exchange’s necessary equity and put their money at risk. From this list, we exclude *a priori* farmers and consumers that do not need to place themselves under the firm’s authority (except those, including local communities, who engage in a socio-political action that may be coordinated by Equal Exchange), and conventional creditors who guarantee their autonomy *vis-à-vis* the firm by diversifying their portfolios and being within the first to be refunded in case of a liquidation.

As we have seen, making a mission explicit may allow the participants to reconsider the roles allocated by the standard governance rules. Within our "mission-centric" framework, three different questions are raised: i) how are the identified stakeholders engaged and how do they create solidarity? ii) who must be the beneficiaries? iii) how are management decisions controlled against the mission?

As the mission states, the main beneficiaries are the farmers. However a mutual choice lead to limit their engagement in the collective project: they only commit themselves to supply food when they receive Equal Exchange's investment. Should they strongly depend on the firm's mission (as their only potential Fair Trade buyer) or not, they do not hand their acting power over the firm's authority beyond this contract. For example, Equal Exchange cannot have a voice about the manner the farmers may choose to grow their production. Thus, on the contrary to the stakeholder basic assumption, beneficiaries are not primary stakeholders or "engaged" participants. The firm's mission is not confused with the workers' interests. It is not confused with the contributors and investors' interests either: it has been defined as the corporation's purpose before considering the "salience" of its stakeholders.

On the other hand, these "necessary" stakeholders must strongly engage in the firm's mission. Workers, of course, which are under the authority of the executives, stake their career, training and employability, purchase an expensive share etc., thus clearly binding their outcome to the firm's success. But investors are committed too: they are offered a choice regarding their level of commitment between the class B preferred stock and the Certificate of Deposit, the latter being a "debt" with guaranteed return over three years, and the former being 5-year non-voting stock with dividends "targeted" at 5%.

Equal Exchange thus look beyond the mere financial contribution (amount and time) to determine the solidarity between the "duty-bound" participants. Against the primary assumption of the shareholder-centric governance, the enterprise offers a higher return to workers although they only contribute for 4% of the total capital. In fact, they are guaranteed two types of financial outcome: wages that are still paid first, and rebates that exceed 100% of their share value, but are paid last, leading them to be a new type of "residual claimants" that echo their high engagement instead of justifying it. It enables the "only" financial investors to avoid this critical position, thus bearing a limited risk that suits their different kind of commitment, and eliminates the need for liquid assets. Instead, both securities (preferred stock and certificate of deposit) mention the mission as the main reason for setting their minimal term; even justifying that $2500 for 3 years is the appropriate investment for a 5- or 6-person family investing in coffee production.

*c) Renewal of the notion of "control" through mission-centric mechanisms*

It also eliminates a third argument of the shareholder primacy tenants: that the residual claim should enable voting rights for financial investors.

We tackle here the third question: how would management decisions be controlled against the common mission? As John Lewis Partnership demonstrates, it is possible to leave a broad discretion to managers, and to relinquish the "principal-agent" model that should align the management decisions to the interests of some rightful stakeholders. Instead, management legitimacy is ensured by its subordination to a mission that circumscribes its field of possibilities. Thus, the decisions and strategies of the chairman and its management team are systematically reviewed against the "ultimate purpose" of the partnership.

This entails two governance characteristics: a guaranteed transparency, which is obtained here through the numerous meetings of the partnership council with the chairman and the independent internal journalism system; along with a specific body, whose function is precisely to assess the management performance against this mission. In this case, the trustees are in charge of assessing the "constitutionality" of the strategy, and of arbitrating in case of a conflict.

Here again, those who are responsible of controlling the management against its mission are not those who benefit from the firm's activities, those who contribute to the resource base of the firm, or those who are the most engaged in the firm, on the contrary to a co-operative form. We can even imagine that this role could be handed over disinterested third parties as would enable a standard assessing the mission[3].

Furthermore, directors and officers taking decisions shall not consider every stakeholder anymore. Rather than an impossible "catch-all" or "fuzzy" norm that would require balancing all the competing interests before each decision, the mission-centric view allows managers to focus on a particular direction, which may of course very well be different from maximizing profits.

Several hypotheses can be put forth to determine what mechanisms may guarantee this control, gathering legitimacy and solidarity requirements. John Lewis Partnership is endowed with a constitution that clearly defines the controlling parameter, and uses the legal obligation

[3] This is, incidentally, the case of the « benefit corporation » status that has passed in seven of the united states, see for example (Munch 2012).

of the Trust to ensure the legitimacy of the control. Equal Exchange relies on several charters, including mainly the Fair Trade charter that was imported from Europe.

Besides, Equal Exchange's cooperative form, although not directly deriving from their primary mission, comes from an explicit choice of the founders to place workers at the centre of their decision-making structure, as a symbol of their wish to reverse the food trade system that privileges prices (and thus finance) over the farmers' condition. Beyond this personal choice, we still observe that those who control the mission are not the main identified beneficiaries themselves or the main financial contributors.

We think it is of interest for further research to identify the mechanisms that may ensure the legitimacy of the mission control, as well as the particular attributes of the fiduciary duties to the corporation that may emerge when the firm is bound to an explicit purpose rather than to a specific group of stakeholders. In this way, we believe that the study of innovative law provisions that amend the corporations code in several states of the US (and especially the *Flexible Purpose Corporation* in California) will be of great contribution.

## 5. Conclusion

Describing Social Enterprises as theoretical "Hybrid forms" between conventional for-profit and non-for-profit organisations is largely insufficient to capture the specific features of this field and reveals the shortcomings of the standard theories of the firm. Contrary to some authors' view, we argue that while Social Entrepreneurship may teach a lot about the existing theories, its peculiar and otherwise unpredictable features actually require a new theoretical framework to be understood. We propose to build on the most recognised of these features, namely the existence of the mission to create a social value that is disconnected from pure shareholder profit.

The mission-centric approach of the firm has implications far beyond social entrepreneurship, though. It gives some insights for enriching conventional views of the firm. Traditional academic debates are still struggling with competing arguments about the rightful stakeholders to be given control rights and social or financial benefits. Moving definitions of the firm that follow imply fuzzy and intractable purposes based on instrumental and implicit normative claims, although numerous studies (as Donaldson & Preston already highlighted in 1995) have shown a mitigated impact of choosing between these different conceptions. We postulate that a novel framework based on the mission might not only better describe the social entrepreneurship field, but also complement the conventional theories faced to increasing enigmas in the firms' behaviour and success.

Theoretically, we believe that changing the fundamental tenet of the corporate governance – namely a form of mandate, or due control, between some "principals-to-be" and the corporation's directors – to study the conditions and consequences of the design of a collective or common purpose may open a vast field of research both in social and conventional entrepreneurship.

It also opens a new path to practically design organisations, and has broad managerial implications, since traditional governance "tools" (such as boards with numerous committees, incentives, monitoring or stakeholder participation systems) are encountering some practical and theoretical limits. They may be complemented by mechanisms that ensure the enactment and the respect of a common mission (such as Trusts, constitutions, charters etc.) and of solidarity rules between the different constituencies of the firm (such as long-term investments, profit and knowledge sharing, legislative assemblies, etc.). In this respect, it is worthwhile noticing that new corporate law in the US has introduced new statutes for companies: not surprisingly, the obligation to formulate and explicit the mission or "purpose" is the core element of these statutes, for instance the *benefit corporation* and the *flexible purpose corporation*.

Further research may thus address these cases and questions along with the global redesigning movement in corporate law, tackling two forgotten questions of contemporary theories: the purpose of the firm and the role of its management.

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